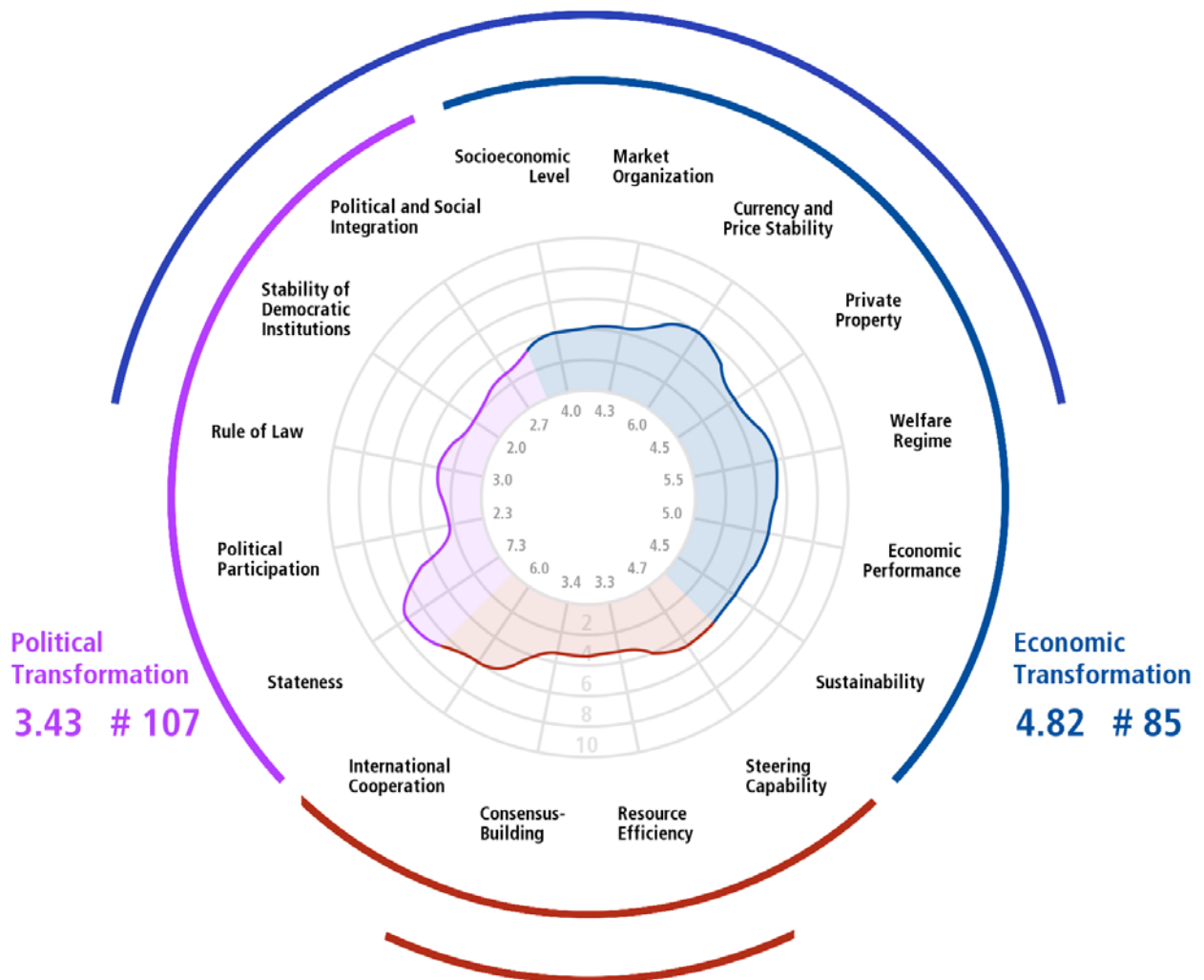


# Azerbaijan

## Status Index

**4.13 # 100**

on 1-10 scale out of 129



## Governance Index

**3.86 # 97**

on 1-10 scale out of 129

This report is part of the Bertelsmann Stiftung's Transformation Index (BTI) 2018. It covers the period from February 1, 2015 to January 31, 2017. The BTI assesses the transformation toward democracy and a market economy as well as the quality of political management in 129 countries. More on the BTI at <http://www.bti-project.org>.

Please cite as follows: Bertelsmann Stiftung, BTI 2018 Country Report – Azerbaijan. Gütersloh: Bertelsmann Stiftung, 2018.

This work is licensed under a [Creative Commons Attribution 4.0 International License](https://creativecommons.org/licenses/by/4.0/).

## Contact

Bertelsmann Stiftung  
Carl-Bertelsmann-Strasse 256  
33111 Gütersloh  
Germany

### **Sabine Donner**

Phone +49 5241 81 81501  
[sabine.donner@bertelsmann-stiftung.de](mailto:sabine.donner@bertelsmann-stiftung.de)

### **Hauke Hartmann**

Phone +49 5241 81 81389  
[hauke.hartmann@bertelsmann-stiftung.de](mailto:hauke.hartmann@bertelsmann-stiftung.de)

### **Robert Schwarz**

Phone +49 5241 81 81402  
[robert.schwarz@bertelsmann-stiftung.de](mailto:robert.schwarz@bertelsmann-stiftung.de)

### **Sabine Steinkamp**

Phone +49 5241 81 81507  
[sabine.steinkamp@bertelsmann-stiftung.de](mailto:sabine.steinkamp@bertelsmann-stiftung.de)

**Key Indicators**

Population	M	9.8	HDI	0.759	GDP p.c., PPP \$	17253
Pop. growth <sup>1</sup>	% p.a.	1.2	HDI rank of 188	78	Gini Index	31.8
Life expectancy	years	71.8	UN Education Index	0.732	Poverty <sup>3</sup>	% 2.7
Urban population	%	54.9	Gender inequality <sup>2</sup>	0.326	Aid per capita \$	7.2

Sources (as of October 2017): The World Bank, World Development Indicators 2017 | UNDP, Human Development Report 2016. Footnotes: (1) Average annual growth rate. (2) Gender Inequality Index (GII). (3) Percentage of population living on less than \$3.20 a day at 2011 international prices.

## Executive Summary

In September 2016, a constitutional referendum, which expanded the power of the presidency by extending the presidential term from five to seven years and by introducing the institution of a vice-presidency, strengthened previous assumptions about the intention of the Azerbaijani regime to gradually transform the country into a full-fledged autocracy.

Parliamentary elections in 2015 were also held in line with this general government policy. No real opposition is represented in the legislative body.

The economic downturn due to falling oil prices, poor economic diversification and mismanagement continues to pose serious challenges to the ruling regime in terms of doing business as usual.

The most important (negative) development in Azerbaijan's economic and political life in recent years has certainly been that in 2015 the country's currency collapsed and lost nearly 100% of its value against the U.S dollar, and was among the worst performing currencies that year. Devaluation continued in 2016 albeit at a slower pace.

Moreover, in 2016, the Azerbaijani economy was among the fastest shrinking economies in the world. In early 2016, deteriorating social problems caused simultaneous protests in various regions of the country. Yet, it seems the government managed to contain the unrest, at least temporarily, by responding with harsh reprisals.

In addition, a continued crackdown on opposition, civil society, civil liberties and a revolving door of arrests paralyzed independent activity in the country. According to many observers, this negative development boosted the chance that various Muslim groups would replace the weakened secular and liberal-democratic forces as the primary voice of dissent.

As a result of the crackdown, in April 2015, Azerbaijan was downgraded in the Extractive Industries Transparency Initiative (EITI), the global standard established to promote an open and accountable management of extractive resources, from ‘compliant’ to ‘candidate.’ Furthermore, in May 2016, Azerbaijan was downgraded to an inactive member in the Open Government Partnership (OGP), a multilateral initiative aiming to secure commitments from governments to promote transparency.

In December 2016, President Ilham Aliyev signed the decree on Strategic Roadmaps for the National Economy and Main Economic Sectors, which set priorities and plans for an economic recovery and development. Yet it remains to be seen whether the decree will be successfully implemented. So far, the leadership of the republic has not made any viable changes in the fight against high levels of corruption, the implementation of the rule of law, respect for private property and accountability of the government, in order to change the tide.

Furthermore, a recent sudden, yet short escalation in the allegedly frozen conflict over Nagorno-Karabakh has evoked the most important structural constraint in the country’s transformation. In early April 2016, the worst armed clashes with Armenia since the cease-fire in 1994 over the secessionist region of the Azerbaijan Republic erupted. This almost full-scale war, which lasted for a few days, claimed hundreds of lives on both sides. Although a restoration of the cease-fire was reached, it raised serious concerns over the possibility of renewed protracted war.

It seems that the conflict de-escalation efforts by the Minsk Group established in the early 1990s and chaired by the US, Russia and France have led nowhere.

The economic and political failures of the ruling elites on conflicting sides, plus mounting political pressure from the regional powers with differing interests, exacerbate the situation further.

## History and Characteristics of Transformation

In the early 19th century, Russia incorporated Transcaucasia into its territories. Among the conquered lands were those that constitute today’s Azerbaijan Republic, where the majority of the population were Turkic-speaking Shia and Sunni Muslims.

Under Russian rule, a new class of national intelligentsia emerged, which modernized the local Muslim society and transformed the Shias and Sunnis of the South Caucasus into secular Azerbaijanis.

The fall of the Russian monarchy in 1917 allowed Azerbaijani nation-building to move on to a state-building process. In 1918, the first Azerbaijani Democratic Republic – a parliamentary democracy with secular laws – was established.

Although the first nation-state did not last long and was dismantled by the 1920 Bolshevik invasion, the nation-building process in Azerbaijan continued to grow and strengthen during Soviet rule.

In the late 1980s, during Gorbachev's perestroika, the dispute between Azerbaijan and Armenia over the Nagorno-Karabakh region reignited the Azeri nationalist movement. After January 1990, when Soviet troops forcibly entered the Azerbaijani capital of Baku, nationalists began to chant slogans of independence. This movement, led by the People's Front, positioned itself as an alternative political force to the Soviet leadership of the country.

On October 18, 1991, Azerbaijan declared its independence and, a few months later, the People's Front overthrew the last communist leader, Ayaz Mutallibov, amid the chaos of war with Armenia. In June 1992, the leader of the People's Front, Abulfaz Elchibey, was elected president of Azerbaijan in the country's most democratic election in recent history.

Elchibey negotiated the withdrawal of Soviet military troops from Azerbaijan with Russian President Boris Yeltsin. But, a year later, he was overthrown in a military coup allegedly backed by Soviet (Russian) security forces. When civil war was imminent, country's former communist leader (1969-1982) and Communist Party of the Soviet Union (CPSU) Politburo member (1982-1987) Heydar Aliyev seized the opportunity to take power.

Aliyev managed to bring stability to Azerbaijan by negotiating a cease-fire with Armenia, appeasing Russia by entering into the CIS agreement, and subduing local warlords. But his most important achievement was the so-called Contract of the Century, whereby Western companies were invited to develop Azerbaijan's oil fields. Aliyev embarked on a strategic initiative to build oil and gas pipelines in order to help Europe diversify its energy supply away from Russian dependency.

Overall, Aliyev succeeded in ending the war with Armenia and bringing stability and security to Azerbaijan through realignment with the West; however, he failed to bring about much-needed democratic reforms.

In 2003, when Heydar Aliyev passed away, power was transferred to his son, Ilham, which marked the first dynastic power transition in the post-Soviet space. Ilham Aliyev maintained the energy policies of his late father, but continued to close the space for independent political activities, the media and civil society. In 2009, in a highly contested referendum, the constitution was amended and the two-term limit on the presidency was lifted. This amendment allowed Ilham Aliyev to run for office again in 2013, when he was elected for a third term in a much criticized election. Following re-election, Ilham Aliyev continued to stifle independent voices and stymie Azerbaijan's democratic progress.

In 2016, another referendum, which extended the presidential term from five to seven years and expanded presidential powers was held, further consolidating the authoritarian regime in the country.

However, since early 2015, severe economic crisis has struck the country. Heavily dependent on fuel commodities, the poorly diversified Azerbaijani economy entered into sudden and steep decline due to a fall of oil prices, corruption and incompetence, thus exposing its severe vulnerabilities. Within the last two years the local currency depreciated more than 100% in relation to the US dollar, dozens of banks were closed, inflation hit the two-digit level, industrial production and the GDP shrunk, fixed investment tumbled and widening fiscal deficit forced the government to cut public expenditure and sharply increase utility prices.

The BTI combines text analysis and numerical assessments. The score for each question is provided below its respective title. The scale ranges from 1 (worst) to 10 (best).

## Transformation Status

### I. Political Transformation

#### 1 | Stateness

Azerbaijan lost control over 17% of its territory during the war with Armenia in the early 1990s. The cease-fire established in 1994 has mostly held for over two decades despite sporadic violations. In early April 2016, the cease-fire was broken for four days, claiming hundreds of lives on both sides. On April 5, the cease-fire was restored under heavy Russian influence.

Azerbaijan regained a tiny portion of its lost territory, including some strategically important elevated locations. However, Armenia downplayed their size and strategic importance. The incident raised the risk of a possible resumption of a protracted full-scale war.

Apart from the lost territories, the Azerbaijan government enjoys an unchallenged monopoly on the use of force in the rest of the country.

However, there are some issues which pose potential threats to the progress of the state-building process, thus challenging the sustainability of the regime's monopoly on power:

- The possibility that Russia and Iran might use the presence of ethnic minorities concentrated in the northern and southern parts of the country, respectively, to instigate separatism as a pretext to destabilize Azerbaijan.
- Although the president of the country, Ilham Aliyev, is still the most powerful political figure in the country, he, unlike his late father, enjoys only limited authority, since he shares power with some very powerful state officials and oligarchs. There is no doubt that the referendum on constitutional changes held in 2016, which, among other things, extended the president's term in office from five to seven years, will increase the power and clout of the head of the state. However, the sharp economic

Question  
Score

Monopoly on the  
use of force

5

'06 '18 10



1

downturn of the last two years and urgent need for reforms may create tensions within the ruling elite.

- Steadily rising signs of religious radicalism are among other potential major challenges to the current situation.

Legally, the entire population, irrespective of race, gender, religion or ethnic background, is guaranteed full citizenship. Despite some minor problems, it is de facto reality as well.

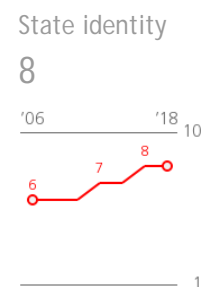
Azerbaijan national identity was gradually shaped by the secularly educated local intelligentsia in the second half of the 19th century, after Russia incorporated Muslim parts of the South Caucasus. It was significantly developed during the first independent Azerbaijan Republic, declared in 1918. The Soviets, who re-conquered Azerbaijan in 1920, however, strengthened Azerbaijan's nation-building process further. After the collapse of the Soviet Union, Azerbaijan state identity faced some challenges, but generally upheld its dominance and continues to gradually become stronger.

The current Azerbaijan government has so far successfully promoted loyalty to state identity through school curricula, textbooks, state propaganda, et cetera. Generally, it is consistent with the foundation of the nation-building process, which started in the 19th century. However, the cult of personality built around former President Heydar Aliyev (father of the current head of state) has been linked to the consolidation of state identity. This policy is likely to be questioned in the future, causing certain unease for the transformation.

In principle, nation-building and state-building in Azerbaijan are based on a strong secular legacy. Yet, after the collapse of the Soviet Union, there was a significant religious revival process in which both domestic and foreign actors played a role. It resulted in the emergence of local pro-Iranian, pro-Turkish and pro-Arabic religious groups, which tend to give preference to their recently acquired religious identities over the secular state identity of Azerbaijan. Some ethnic minorities have also expressed resentment against the rise of Turkic nationalism among the majority population after the collapse of the Soviet Union.

The major challenge to the nation-state identity came from Armenians in Nagorno-Karabakh who launched a separatist movement just before the collapse of the Soviet Union.

In 1919, after World War I, a mandate for the region was given to the British, and they handed the control over the Karabakh region to the Azerbaijan government. In the 1920s, after Sovietization, the communist state again put the status of the disputed territories into question. Eventually, in the mountainous part of Karabakh, where the majority of the population were Armenians, an autonomous oblast, legally subordinate to Azerbaijan, was created. In the late 1980s, during Gorbachev's





perestroika, the Armenian majority in Nagorno-Karabakh Oblast demanded secession from Azerbaijan to join Armenia. In late 1989, the Supreme Soviet of the Armenian Soviet Republic passed a resolution on integrating Nagorno-Karabakh into Armenia. Hostilities between the two sides transformed into a major war after the collapse of the Soviet Union. Azerbaijan lost control over Nagorno-Karabakh and the adjacent seven districts. A cease-fire was established in 1994. In 1992, the then-CSCE Council launched an initiative to negotiate a peace deal between the two countries and in 1994, OSCE's Minsk Group, chaired by France, Russia and the United States was established to find a peaceful solution to the Nagorno-Karabakh conflict. However, it has not yet produced any results.

Apart from reaching peace with Armenia, issues like economic prosperity, inclusiveness, government accountability, as well as the successful establishment of the rule of law are key for securing and sustaining the state identity.

Azerbaijan is a secular state, and the legal order is defined by civil law. Religious organizations and members of the clergy are forbidden from participating in elections. Although Azerbaijani society has managed to preserve its overwhelming secular nature, from time to time, some religious groups try to be active in political life, though they are heavy-handedly suppressed by the government.

In November 2015, state police initiated a special operation against a group of Muslim religious activists led by the outspoken Shi'a cleric Haji Taleh Bagirzade, in Nardaran on the outskirts of the capital Baku. According to official statements, six men, including two policemen, lost their lives during the operation. Law enforcement staged this operation, claiming that Taleh Bagirzade led an armed group aiming to seize power and to establish Shariah-based rule. The head of state police specified that they acted on the president's orders. However, the legitimacy of this operation was challenged by the majority of local and international human rights organizations.

Commemorations of Ashura by Shi'a Muslims as a day of mourning for the Prophet Muhammad's slain grandchild Hussein is the most crowded annual religious ceremony in the country. In 2015, attendance reached the highest numbers since independence, approximately several tens of thousands. However, since 2016, the government has applied variety of legal and administrative restrictions on the observation of Ashura commemorations.

Since early 2014, the issue of Azerbaijani Sunni radicals joining Islamic jihadists in Iraq and Syria has regularly popped up in Azerbaijani media outlets. These were followed by the government's decision to close some mosques and imprison alleged, homegrown jihadists. Reports on anti-terrorist operations held by the state security forces against the Salafi jihadists in various parts of the country intensified in 2016. In December 2015, parliament adopted a special Law on the Fight Against Religious Extremism.

No interference of religious dogmas

9



1

However, diminishing space for the activities of civil society and independent media, very well documented by international human rights organizations, boosts the chances that various religious groups will replace weakened secular and liberal-democratic forces as a voice of dissent.

Also, it should be noted that the government uses the country's Islamic identity as a resource in both domestic and foreign policies. In 2017, Azerbaijan will, for example, host the Fourth Islamic Solidarity Games.

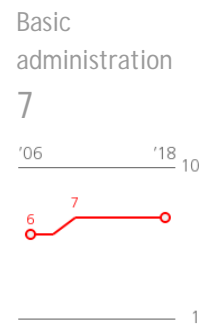
The state provides such basic services as health care, education, tax collection, social services, transportation, law and order through its fully functioning bureaucratic system and infrastructure, although the quality and standards of these services are not sufficiently advanced. During the period under review, there were some noticeable improvements in public transportation services, especially in the capital Baku.

Corruption and bribery still remain the biggest hindrances to the system. However, the increasing number of Azerbaijani Service and Assessment Network (ASAN) public centers across the country and the range of services they provide has augmented efficiency in some areas by continuing to reduce mid- and low-level bureaucratic corruption.

According to data from the World Health Organization published in 2015, 89% of the population of Azerbaijan has access to improved sanitation facilities, and 87% uses improved drinking water sources.

A well-functioning informal hierarchy of power exists in the government structure. Each of the powerful oligarchs (high-ranking officials) supervises several ministries. These oligarchs (some are ministers themselves) also share responsibility for the performance of heads of regional executive offices, appointed by the president upon their recommendations.

Independent Azerbaijan inherited the Soviet-established regional administrative system, which has remained largely unchanged since. The administrative apparatus in the provinces and cities are led by heads of executive offices, who enjoy relative independence and vast administrative powers. They possess personal responsibility for economic performance and social well-being, as well as for the provision of political stability and the promotion of popular loyalty to the regime in their respective provinces.



## 2 | Political Participation

In a highly disputed referendum in 2009, an amendment was made to the constitution lifting the two-term limit on presidency. This amendment paved the way for President Ilham Aliyev to be elected for the third time in presidential elections in 2013.

In 2016, another referendum was held, which increased the term of presidency from five to seven years and further strengthened the power of president over the parliament. According to the newly introduced and adopted Article 98 (1), the president is vested with extensive powers to dissolve the parliament. The referendum was held in a highly repressive environment. Groups opposing the amendments were persecuted by law enforcement authorities.

The last legislative elections in November 2015 were held in an even less competitive environment in comparison with previous elections. For the first time since the independence, election campaigns were held without televised debates among the candidates. Most opposition parties refused to participate in the elections or withdrew their candidates before election day. Thus, no opposition is represented in the country's parliament.

Insignificant authority and distrust in the fairness of elections seriously reduce interest in contests for municipal seats. Plus, major cities, including the capital, do not have elected mayors.

Election commissions are composed overwhelmingly of regime loyalists, who carry out orders received from the presidential office. The ruling party exercises extensive control over news and information content and enjoys enormously disproportionate coverage. The opposition is literally denied access to television stations broadcasting from Azerbaijan.

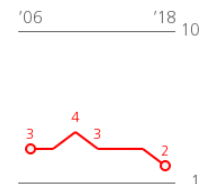
Election days are marred by multiple voting, ballot stuffing, interference with vote counting and other irregularities.

The Constitutional Court remains a rubber-stamp body, with no real power to challenge election results.

At the national level, the president exercises control over governance of the country. The referendum in 2016 further strengthened presidential powers. Apart from the newly adopted Article 98 (1), which expanded the power of the president over the parliament, the referendum extended the head of state's term in office from five to seven years. Plus, offices of vice-presidents were created and president was given rights to appoint them. The first vice-president replaced the prime minister as second person in line of succession. So the president can now pick his successor without seeking approval from the legislature.

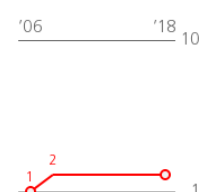
Free and fair elections

2



Effective power to govern

2



Parliament and local municipal representatives, despite being nominally elected by the people, remain passive participants in the policy-making process. Yet, the entrenched interests of the state elite, the oligarchs, government ministers and other high-ranking officials, limit the president's power.

But, in October 2015, one of these powerful oligarchs, namely Minister of National Security Eldar Mahmudov, was fired. The ministry itself was divided into two independent intelligence agencies, the State Security Service and the Foreign Intelligence Service.

The military is under the control of the president, while head of the powerful state police, Minister of Internal Affairs Ramil Usubov, is regarded as more loyal to Chief of Staff (in the presidential administration) Ramiz Mehtiyev, who is the second most powerful person after the president. Since the death of former President Heydar Aliyev, Ramiz Mehtiyev has enjoyed more autonomy in comparison with the other oligarchs.

Members of parliament are often protégés and relatives of oligarchs.

Meritocracy in the bureaucratic system is compromised by deep-rooted clientelism, cronyism and nepotism. Traditionally, two major regional groups tied to the regime (Nakhichevanis and ethnic Azerbaijanis from Armenia) have dominated the system. However, since 2003, groups tied to the president's wife have to some degree challenged the monopoly of these two regional groups among high-ranking officials.

Additionally, the demand for skilled professionals in businesses and important state structures paves the way for meritocracy. This is starting to somewhat challenge regional clientelism among mid-level career specialists in both business and government positions.

Russia, the U.S., EU and Turkey are able, directly or indirectly, to influence Azerbaijan's government policies. For decades, the Azerbaijani ruling elite has boasted of its so-called "balanced foreign policy," which means remaining equidistant from the West and Russia.

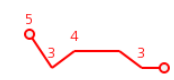
Freedoms of assembly and association are guaranteed by the constitution, but severely restricted in reality. No rallies are allowed in city centers. The government closely monitors participants at authorized rallies, launching various forms of oppression against them, which include long- and short-term imprisonment, job loss, et cetera.

Since 2013, the government has launched a massive crackdown on civil society, journalists and political opponents, in an attempt to close the space for independent activity and critical voices. Despite the fact that some jailed activists were released

Association /  
assembly rights

3

'06 '18 10



1

in 2015 and 2016, the crackdown never stopped and the revolving door of arrests continued.

Those who attended authorized opposition rallies in 2016 to protest the changes to the constitution received especially harsh treatment from law enforcement. Even members of the groups that tried to conduct a public education campaign against proposed changes, within the legal framework defined by the law, were detained, and their leaflets and other information materials were seized. Police explicitly forbade any kind of campaigning.

All of the specially designated venues for press conferences and roundtables are under the control of government officials, and they use both administrative and financial methods to restrict access by independents and government critics to these places. Some offices of opposition groups, political parties and NGOs remain the only places thus far tolerated by law enforcement, where dissidents can gather and organize public events.

The government also pressures hotels and other venues in downtown and other central parts of Baku not to provide opposition parties and independent NGOs with space to hold their events. However, opposition political parties were allowed to hold their major conferences, though not in central locations in the capital.

The situation is direr in the provinces, with Nakhichevan Autonomous Republic being the most restrictive place. Yet, during the period under review, there were several major unauthorized protests in certain regions. In summer 2015, in Mingachevir, people poured into the streets demanding an explanation for the death of a man in police custody.

In early 2016, rallies took place in Siyazan, Fuzuli, Lenkoran, Agcabedi, Beylagan and other regions almost simultaneously. These were sparked by the harsh economic downturn, unemployment, inflation and the devaluation of the national currency. All of these rallies were heavily suppressed by law enforcement. Participants at the rally in Siyazan city received especially harsh treatment.

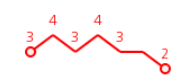
The constitution of Azerbaijan guarantees freedom of expression. However, during the period under review the government continued to restrict space for free media. As a result, freedom of the press deteriorated further, according to the 2016 World Press Freedom Index, published by Reporters Without Borders. The country ranked 163th out of 180 countries in this report. In the same index Azerbaijan was ranked 160th in 2014 and 162nd in 2015.

Journalists from Meydan TV, a Berlin-based Azerbaijani media organization, faced particular pressure. The Azerbaijani Prosecutor's Office launched a criminal investigation against Meydan TV and 15 individuals were named in it. A number of journalists connected with this case have been barred from leaving the country. A relative of the executive director of Meydan TV was arrested on trumped-up charges.

Freedom of expression

2

'06 '18 10



Relatives of the founder of Azerbaijan Saati, another foreign-based TV broadcast network, were arrested and indicted on trumped-up charges as well.

The only oppositional print outlet, Azadliq newspaper, stopped printing due to financial problems and currently only maintains its online version. Stifled economically, independent Azerbaijani newspaper Zerkalo, published in Russian, stopped printing as well.

Journalists at these two newspapers have been jailed in recent years. While Zerkalo's Rauf Mirgadiriov was released on presidential pardon, Azadliq's columnist Seymur Hazi remains in prison. Moreover, another employee of Azadliq, responsible for technical management was imprisoned on trumped-up charges in 2016.

There are some other jailed journalists in Azerbaijan as well. However, some, including the most prominent investigative journalist Khadija Ismayilova, were released, although she remains under travel ban.

Television stations in the country are fully controlled by the government. Independent voices do not have access to television. ANS TV, which was among country's first privately owned media since the collapse of the Soviet Union, was shut down after alleged pressure from the Turkish government due to the intention to air an interview with the US-based Muslim cleric Fethullah Gülen.

Radio Free Europe/Radio Liberty, BBC and Voice of America remain off air, since they were banned from broadcasting on FM waves in early 2009.

Legal amendments that limit access to information were introduced after investigative journalists revealed widespread corruption linked to the ruling family. In 2016, new amendments to the criminal code aiming at protecting the president's honor and dignity from abuse in literature, mass media, internet and social networks were adopted.

The government always highlights the fact that access to the internet is unrestricted, and that the number of users is actually increasing. Until recently, this was largely the case. However, bloggers who criticize the government, especially those on Facebook, are constantly pressured, persecuted and jailed and the government has started intermittently blocking some websites.

### 3 | Rule of Law

The executive branch dominates the other branches of the government, and there is practically no functioning system of checks and balances in the country. Separation of powers exists only on paper. All important decisions are made by the presidential office.

Separation of  
powers  
2

Parliament continues to remain a rubber-stamp body, without the capability to effectively check and balance the executive branch of government. Apart from having legally restrictive powers, the parliament's inability to control government policies derives from the way it is composed. Parliamentary elections are a mere formality. In reality, members of parliament are not elected, but rather selected and appointed by the executive branch i.e., the presidential administration.

Accordingly, the members of parliament are protégés and relatives of influential executive office holders. They simply carry out orders received directly from the presidential office, which is, in fact, the sole possessor of the legislative authority.

There is no independent judiciary either. The courts are corrupt and operate as a punitive mechanism in the hands of the executive power. The situation has deteriorated further due to a wave of disbarments of independent defense lawyers.

Professional examinations are included in the selection process for judges. However, political loyalty to the regime, assessed through background checks and interviews, remains the top priority. The government heavily interferes and has the last say in court decisions made regarding political, economic and other publicly sensitive cases. Thus, while the administrative capacity of courts may have improved, their political independence has rather deteriorated.

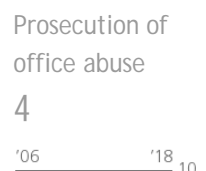
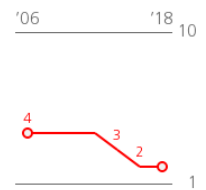
No significant improvements have been made in combating widespread corruption in the courts either. In the rulings of ordinary civil and criminal cases, corruption is still an important deficiency, heavily interfering with decision-making.

Defense attorneys to a great extent play only a formal role and have minimal influence over court rulings. The bar association is also controlled by the executive, and is frequently used as a tool to penalize independent defense attorneys. Dismissals, and even disbarment of defense lawyers who do not bend to the pressures of executive power, remain a worrying issue.

The European Court of Human Rights (ECHR) remains the widely trusted last chance for justice-seekers in Azerbaijan. However, in the last few years the government has delayed and even ignored the decisions made by the ECHR, as happened in the case of political prisoner Ilgar Mammadov.

As yet, there is no serious political will to undermine the existing oligarchic system, which is based on cronyism, nepotism, clientelism, high-level corruption and personal loyalty, rather than rule of law.

Despite the existence of the State Commission on Combating Corruption and the Anti-Corruption Department of the Prosecutor General's Office of Azerbaijan, mainly mid-level officials have been targeted. This has been used as a tool to silence political opponents, active civil society members and media organizations, as well.



However, in 2015, some high-ranking officials, including the minister of National Security and the minister of Communications and Information Technologies, were fired. Many officials in these institutions, as well as the head of the International Bank of Azerbaijan, were tried in a court of law. Charges brought against the accused included embezzlement, money laundering and bribery, among others. There is no doubt that high-level corruption was the norm in these offices, although the main reason behind the trials, according to independent commentators, was a breach in personal loyalty to the president.

The reawakening of civil activism, particularly among the younger generation inspired by the Arab Spring and the popularization of social networking, has led to further suppression of civil rights and liberties in Azerbaijan. The government has launched major crackdown against political dissent, civil society, human rights activists, the media, international NGOs and youth organizations.

Although civil rights are protected by the constitution, cases of police violence take place on a rather frequent basis. The Office of the Ombudsman is more formal than functional and operates just as the government's spokesperson on issues within its jurisdiction.

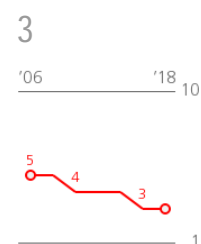
Legally, Azerbaijan is fully committed to gender equality and contains relevant provisions in its constitution and has signed many international conventions. Nevertheless, patriarchal norms and values are still dominant in the overall conservative society. However, the transformation process is accelerating and women's status both within the family and public life is gradually increasing.

Azerbaijan ranked 96th out of 145 countries in the Global Gender Gap Report of the World Economic Forum, published in 2015.

Even though Azerbaijan has decriminalized homosexuality, there is still a serious infringement on the rights of LGBTI citizens. The country has been ranked the worst place in Europe to live as an LGBTI citizen, according to the ILGA-Europe Rainbow Index.

Ethnic discrimination does not appear to be a major problem in Azerbaijan. Azerbaijanis of various religious backgrounds enjoy equality and tolerance, although some non-traditional religious groups, such as evangelists and some Muslim groups, often face government restrictions. The year 2016 was officially declared the "year of multiculturalism" by presidential decree.

Civil rights





#### 4 | Stability of Democratic Institutions

Azerbaijan is a consolidated authoritarian state with democratic institutions existing only nominally. In reality, all power is vested in the hands of the executive. Since 1995, the parliament has been dominated by the ruling New Azerbaijan Party, and the government has gradually restricted presence of opposition parties in the legislature by manipulating elections.

The government imitates a multiparty system. It tolerates only those parties, which agree to relinquish criticism of the government. In 2002, a referendum was held to eliminate party-list proportional representation, leaving only a majoritarian (single-member constituency) system. In the 2010 elections, only political parties that did not challenge the authority of the government and operated under its broad supervision were given seats in parliament. The situation was repeated in the parliamentary elections of 2015. Real opposition parties are left outside.

Despite the fact that currently parliament is heavily dependent on the executive and exists only in a formal sense, there is still a legal basis for separation of powers. In case there are free and fair elections, parliament could contribute to checks and balances, and fulfill its role as assuring accountability on the part of the executive.

The judiciary is also under full control of the executive. However, if a separation of powers occurs and there is the political will to fight corrupt practices, the judiciary will also be professionally able to meet its obligations as a democratic institution.

Elected municipal representatives exist. However, there are neither elected mayors of cities, nor elected regional governors. Regional and city legislatures do not exist either. All the power is concentrated in the hands of heads of local executive offices appointed by the president. Thus, informally, municipalities completely depend on those powerful heads of regional or city executive offices.

The government always stresses its commitment to building a democracy and/or strengthening democratic institutions. However, the continuous crackdown on political opponents, civil society and the media only testifies that this is just lip service, and that it is not willing to tolerate democratization either of society or of the government itself. For instance, the referenda of 2002, 2009 and 2016 eliminated the party-list proportional representation voting system for the legislature, phased out the two-term limit for the presidency and extended head of state's terms from five to seven years.

So far almost all the government agencies and power players have been loyal to this policy, with the police being the most anti-democratic institution. Relatively young bureaucrats, exposed to western education or lifestyle, who replaced aging officials in some of the high-ranking government posts, have brought about only minor

Performance of democratic institutions

2

'06 '18 10

2

1

Commitment to democratic institutions

2

'06 '18 10

2

1

changes. The main course of the government remains intact and the assault on democratic rights continues to intensify.

Traditional secular parties were in strong opposition to the government, but never clearly defined their ideology. But during the past few years this tendency has changed. Well-defined, liberal-democratic-minded organizations led by the newly emerged young middle-class have been seriously challenging the dominance of the traditional opposition parties. However, the aforementioned crackdowns have seriously damaged, if not halted, this process.

## 5 | Political and Social Integration

Azerbaijan is an authoritarian state, dominated by one ruling party. Currently, there are two major registered oppositional parties, i.e. Musavat and the People's Front. Both have declared their commitment to liberal-democratic principles, but have never pursued a well-defined systematic promotion of these values. Similar to the ruling party, they are prone to personal politics.

In the 2010 and 2015 parliamentary elections, neither party was allowed into parliament, which, along with growing government pressure, seriously damaged them.

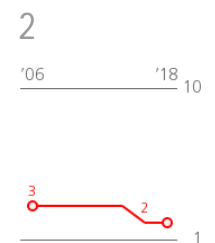
In 2014, the longstanding leader of Musavat left the leadership post according to the rules of the party and a new chairman was elected. However, the results of the election were disputed and the ensuing fragmentation accelerated the party's decline.

The People's Front Party, in turn, was stripped of its headquarters. In addition, imprisonment of a large number of its activists and high-ranking members has intensified throughout the years. The core of party's members remained in prison by the end of 2016.

However, the entry of Western-educated youth into public life during the last few years, and the emergence of young social middle-class and strong mid-level career professionals interested in active public life, have paved the way for the birth of new pro-Western political groups, such as the Republican Alternative (REAL) and NIDA civic movement.

Nonetheless, these organizations have suffered serious blows due to ongoing pressure from the government which has increasingly taken the form of a crackdown. The entire leadership of NIDA was imprisoned in the early stages of the crackdown and then released in 2015 and 2016. Some NIDA activists remained in prison by the end of the reporting period as well.

Party system



Arrested in 2013, the chair of REAL still remains behind bars. Another board member of the organization was released in 2016 after remaining in jail for a year and a half.

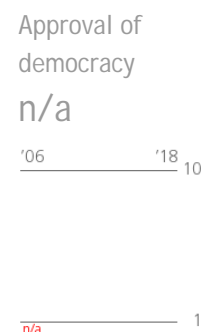
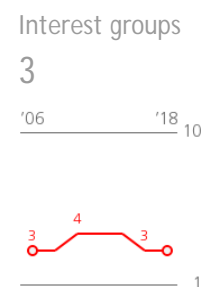
The rest of the political parties are mainly controlled by the regime and pursue a pro-governmental or even a government-set agenda.

Since the late 2000s, a number of influential interest groups have started developing in the form of NGOs, cultural, religious, social, human rights and ideological networks. They were concentrated mainly in the capital Baku, as well as in some other major cities, though largely absent from rural areas. These newly emerged groups started challenging the establishment, i.e., the domination of Soviet-style organizations (for example, the trade unions, the Writers Union, the Caucasus Muslim Board, et cetera), which continue their formal existence as semi-official bodies. The emerging new organizations were rapidly gaining strength and started posing a real challenge to the existing system, attracting more attention and mobilizing more active people around themselves. However, this unexpected success made them primary targets in the ongoing crackdown. Many faced numerous administrative and legal restrictions: leaders of some organizations were arrested on dubious charges, and criminal investigations were launched; some others were stripped of their rented premises and others lost their funds due to restrictions imposed on donors; laws were toughened and all of these actions made the environment almost non-operational. As a result, many have ceased their activities. The process was completely halted.

However, since early 2016, some still very weak signs of revival of independent activity have started emerging again. Despite facing enormous pressure and interference from the government, some civil society activists launched new organizations, and some old NGOs revived still fragile activities. Human rights defenders released from prison reinitiated coordinated efforts to help those still remaining in jail. Public lectures of independent and opposition groups have been resumed.

Although after the collapse of the Soviet Union, Azerbaijani citizens did not have sufficient information about and experience of democracy's basic principles, such as the separation of powers or multiparty systems and so on, there was strong support for the concept of democracy and integration into the Euro-Atlantic sphere among the population. During the last few years, with a growing number of individuals exposed to Western education entering public life, and through civic initiatives supported by international and local NGOs, knowledge of the basic principles of democracy has expanded, raising hopes for a possibility of gradual change that would lead ultimately to democratization in the country.

However, the government's constant criticism of democratic principles and human rights as tools for the promotion of Western imperialism have stirred doubts about liberal-democratic values among some parts of the population. Propaganda from



neighboring Iran, Turkey and Russia pushes this uncertainty further. In addition, the crackdown on secular political parties and civil society and the shrinking space for independent activity may contribute to the expansion of political Islam, which pursues establishment of Shariah rule. The recent global retreat of democracy, the halt of the spread of liberal values, and the worldwide rise of authoritarianism and right and left extremism are stimulating a decline of trust in liberal-democratic values as well. Nevertheless, the majority in Azerbaijan still believes in the merits of government accountability and the rule of law.

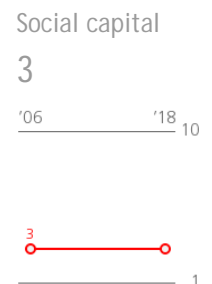
The bulk of social capital in Azerbaijan is centered in rather homogenous family and kinship ties, regional identities and in groups of close friends. Membership in such associations is based on the rights of birth, marriage or high interpersonal trust. These kinds of social trust and social relations have always been greater in the rural regions outside the capital, and with expanding urbanization and modernization, they have been gradually decreasing. They have been declining in comparison with Soviet times as well.

It should be noted that the rampant corruption and absence of the rule of law has been seriously damaging to social trust in society.

According to World Values Survey data encompassing the period between 2010 and 2014, 93.9% of Azerbaijanis say that family is important in their lives. However, only 65% trust their families completely and 21.65% trust them somewhat. At 51.7%, Azerbaijanis ranked the 6th highest among 59 nations in response to the question of whether “Tradition is important to them; to follow the customs handed down by one’s religion or family.” Yet, for clarification purposes, it is important to add that Azerbaijan usually ranks among the least religious nations in worldwide studies, as was case in the 2015 survey conducted by Gallup International.

Although participation in formal civil associations, such as membership in NGOs has generally remained limited, but had been steadily growing in the capital city until the recent crackdowns. However, this trend has been gradually reviving since early 2016.

In general, however, society remains accustomed to demanding action from the government rather than engaging in self-help.



## II. Economic Transformation

### 6 | Level of Socioeconomic Development

Azerbaijan's economy has sharply declined and even deteriorated in the past two years, primarily, due to the fall of oil prices. The year 2016 was the most difficult of the last decade. Since February 2015, the local currency, the manat, has depreciated by more than 100%. In 2016, GDP decline reached nearly 4%. Inflation was on the rise, exceeding 11% in July 2016, according to official data, reaching 12.1% by the end of the year. Under these circumstances, according to the World Bank, "steady poverty reduction over the past decade, fueled by growing oil revenues, is unlikely to continue in 2016. A poverty impact simulation of the inflation spike of June 2015 to February 2016 indicates that close to 300,000 Azerbaijanis could be forced to live on less than AZN 72.5 per month, a consumption level about half the official poverty line of AZN 135.6 in 2015."

In 2015, Azerbaijan ranked 78th in the Human Development Index. The official GDP per capita comprised around \$7812. Whereas in developed countries, GDP per capita aligns with the average salary level, in Azerbaijan the official per capita numbers are more than 10 times the average salaries. Despite large oil wealth, the majority of the Azerbaijani population receive very low salaries that are enough to cover only basic needs. These salaries are mostly uniform for government-funded jobs. Salaries in private firms tend to be higher, with the highest being paid by foreign companies. This leads to a big income gap between Western-educated and locally educated, as well as rural and urban, populations. According to World Bank estimates, the Gini Index of Azerbaijan is 33.7. People who have ties to the ruling elite enjoy more privileges and better living conditions than the rest of the country.

Most internally displaced persons (IDPs) and refugees still struggle with poverty. Yet, according to the World Bank, the poverty rate had declined, and in 2013 only 5.3% of the population was living below the poverty line.

The rural population is less affected by poverty than parts of the urban population; inhabitants of small towns, in particular, take refuge in the largely privatized agricultural sector.

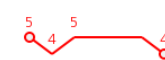
Dire living conditions, especially in provincial towns and rural areas, have resulted in high (labor) migration. Conservative estimates place the number of temporary or permanent emigrants – mainly to Russia – at approximately 1 to 1.5 million. However, due to the economic crisis in Russia, a return of some labor migrants from Russia is expected.

Question  
Score

Socioeconomic  
barriers

4

'06 '18 10



1

Economic indicators		2013	2014	2015	2016
GDP	\$ M	74164.4	75244.2	53074.4	<b>37847.7</b>
GDP growth	%	5.8	2.0	1.1	<b>-3.1</b>
Inflation (CPI)	%	2.4	1.4	4.2	<b>4.2</b>
Unemployment	%	5.0	4.9	5.0	<b>5.1</b>
Foreign direct investment	% of GDP	3.5	5.9	7.6	<b>11.9</b>
Export growth	%	1.5	-1.1	-	-
Import growth	%	10.0	4.1	-	-
Current account balance	\$ M	12231.7	10208.8	-222.5	<b>-1363.4</b>
Public debt	% of GDP	12.8	14.4	35.0	<b>51.1</b>
External debt	\$ M	10065.1	11787.8	13216.2	<b>14085.3</b>
Total debt service	\$ M	2473.9	1780.2	1105.6	<b>1498.7</b>
Net lending/borrowing	% of GDP	4.9	4.6	-2.7	-
Tax revenue	% of GDP	13.4	14.2	15.6	-
Government consumption	% of GDP	11.1	10.9	12.4	<b>13.1</b>
Public education spending	% of GDP	2.5	2.6	-	-
Public health spending	% of GDP	1.2	1.2	-	-
R&D expenditure	% of GDP	0.2	0.2	0.2	-
Military expenditure	% of GDP	4.5	4.6	5.6	<b>3.6</b>

Sources (as of October 2017): The World Bank, World Development Indicators | International Monetary Fund (IMF), World Economic Outlook | Stockholm International Peace Research Institute (SIPRI), Military Expenditure Database.

## 7 | Organization of the Market and Competition

On paper Azerbaijan has a market economy. Although there are clear rules and laws aimed at regulating market competition, they are just a formality.

Small businesses in Azerbaijan face various forms of discrimination. The reason is the lack of competition and preferential treatment of large and state-owned enterprises.

Market-based  
competition  
4

Only a small percentage of firms in Azerbaijan engage in export. A significant share of firms that export are state-owned, which is the result of the high rate of export of raw materials, especially oil. This hinders the ability on non-oil sector SMEs to develop. Import procedures and tariff-free barriers also discourage small businesses from engaging in import activities.

Small businesses also face numerous irregular inspections, which most of the time result in unofficial payments (bribes) to the inspectors in order to keep “good relations” with them.

In 2015, the president signed a decree on the reduction of licensing requirements, to ensure transparency and the easing of procedures.

In addition, in 2015, parliament adopted the On the Suspension of Inspections in the Field of Entrepreneurship Law, introduced by the president. According to this new law, all “unnecessary inspections” have been suspended for a period of two years.

Some local independent economic analysts see this a positive step toward the development of SMEs.

However, in reality, these have not been very effective, as many hurdles still remain, such as high taxes, limited or no access to credit and monopoly on the import of many goods.

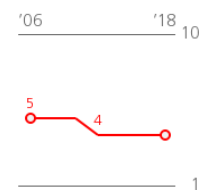
Access to finance is one of the biggest problems that small entrepreneurs in Azerbaijan experience. The credit supply is very limited, and in fact, almost 90% of SMEs use their own resources for their operating capital.

The informal sector constitutes a significant part of the economy. Pricing is controlled by the state in many sectors of the economy, including oil, electricity and gas. At the end of 2014, the oil prices declined worldwide. As a result, the price of oil in Azerbaijan, which produces and sells a significant quantity of oil to neighboring countries, also declined. Prices on non-state regulated goods and services are also influenced by regular informal payments to tax and customs authorities.

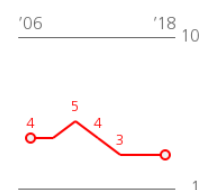
Although there are rules and laws aimed at increasing market competitiveness, these laws are bypassed, taking into account the high level of corruption in government offices.

Since the fall of the Soviet Union, there has been a lot of privatization of large enterprises, however, they continue to be controlled by monopolies tied to high-ranking government officials. Many small, and especially mid-sized companies are also owned by the oligarchs and informally tied to their large business.

Moreover, monopoly-holding officials fight possible competitors by restricting their access to the domestic market and forcing them out of business.



Anti-monopoly policy  
3



Azerbaijan is an oil-based economy and the State Oil Company (SOCAR) controls the major share of this industry. However, some foreign oil companies, primarily BP, played a significant role in the post-Soviet oil industry of Azerbaijan.

The State Committee on Anti-Monopoly Policy and Consumer Rights Protection within the Ministry of Economic Development exists as a mere formality and does not play any serious regulatory role in the country's economy and has been ineffective in enforcing competition laws. The committee lacks resources and capabilities, and most importantly the independence needed to fight the monopolistic nature of the economy and help transform it into a modern market economy.

In 2016, the president signed a law to amend the Law of the Republic of Azerbaijan on Anti-Monopoly Activity. With this amendment, the concept of cartel agreements has been added to existing legislation.

Azerbaijan has somewhat integrated into the world economy, especially in the area of energy exports. The Baku-Tbilisi-Ceyhan (BTC) pipeline crossing the territories of Azerbaijan, Georgia and Turkey transports oil from the Caspian to Western markets. The country has also recently agreed to the Trans-Adriatic Pipeline project, which will transport gas from the Caspian Basin to Western Europe.

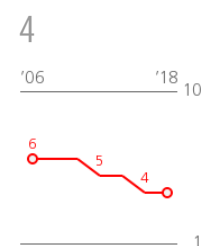
The situation is rather different in other sectors of foreign trade. Significant barriers hinder local entrepreneurs from bringing products into or out of the country for sale. In this regard, the customs committee has been very corrupt and a major obstacle to trade.

The biggest challenges that companies face in foreign trade are: high transportation costs; high tariffs, corruption and extensive bureaucracy in customs; wide-ranging powers granted to the authorities; and additional expenses related to obtaining permits and standardization procedures. High informal fees and long waiting times at the borders hinder Azerbaijan's potential as competitive cargo transit route as well.

The Decree on Foreign Trade lists products, such as construction services, that can be imported and exported upon approval of the Cabinet of Ministers or the Ministry of Economic Development. However, the law does not address the grounds for refusal of such approvals, leaving much to the discretion of government authorities. This creates complications for entrepreneurs and excludes many from import/export activities. Thus, trade still remains largely restricted to few big players.

In December 2016, the president signed a decree on the "Roadmap of the National Economy and its Main Sectors." As part of this decree, a bigger focus will be given to an export-oriented economic model. The goal is to transition to an export-oriented economy that yields higher value-added products.

Liberalization of foreign trade





According to the 2016 World Bank Doing Business Report, Azerbaijan has taken some steps towards facilitating foreign trade, such as “streamlining internal customs procedures.”

According to the State Customs Committee in 2016, Azerbaijan has engaged in trade with 183 countries, compared to 162 in 2015.

However, despite this, foreign trade transactions were almost 20% less in 2016 than in 2015.

Negotiations between Azerbaijan and the WTO regarding trade liberalization and membership have not yielded tangible results, as, in reality, Azerbaijan does not intend to become a member of the WTO because joining this organization would make the country subject to international standards, threatening the high degree of corruption that exists in the economy.

The banking sector experienced a serious contraction in 2016. In February 2016, the president signed a decree on the creation of the Financial Market Supervisory Board (FMSB). This board is a public legal entity that is in charge of licensing and regulating the securities market, banks and other credit organizations, as well as ensuring transparency in the financial sector.

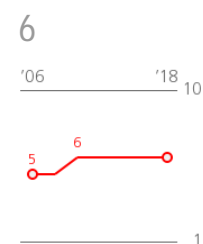
With the establishment of the FMSB, the central bank has lost many of its powers. In March 2016, the president issued a decree limiting the functions of the central bank to ensure stability in the banking system. In addition, the central bank’s right to license credit institutions has also been revoked.

Overall the banking system is noncompetitive and to a great degree controlled by the ruling regime. There are 31 banks operating in the country. In 2016, 11 banks lost their licenses. This was explained by their inability to meet the requirements set by the central bank. About ten years ago, nearly 60% of bank assets were government-owned. Although the process of privatization of state-owned banks has officially been completed, in reality, the vast majority still belongs to high-ranking government officials. Officially, the International Bank of Azerbaijan (IBA) remains the only majority state-owned bank.

However, in 2016, the head of the FMSB, Rufat Aslanli, announced plans to privatize the bank, calling IBA a threat to the banking sector. Mr. Aslanli stated that the fact that IBA controls over 40% of the banking sector contributes to the instability of the banking system. Privatization of the bank is expected to be completed within the next five years.

Foreign capital in the banking system is negligible. According to the IMF, there are eight majority foreign-owned banks. Only 22 banks have some foreign investment. International banks cannot operate in Azerbaijan under free terms.

Banking system



With the manat depreciating there was a run on banks, with people trying to get dollars in exchange for manats, or to change their manat accounts to dollar accounts. Some tried to withdraw the entire contents of their dollar accounts. After the February 2015 devaluation of the manat, over 70% of bank deposits were denominated in foreign currency.

Because of the depreciation, there was a shortage of foreign currency. Some commercial banks have set limits on the sale of foreign currency, while others have stopped selling it altogether.

Additionally, as a result of the decline in oil prices and resulting currency devaluations, the ratio of non-performing loans has increased significantly from 4.9% in 2015, to approximately 9%. This has also contributed to banks' capital to assets ratio to decline from 17% in 2014 to 14.5% in 2015.

## 8 | Currency and Price Stability

Following the drop in oil prices, on February 21, 2015, the central bank of Azerbaijan (CBA) devalued the manat by 33.5% to the dollar. The bank explained this decision as a necessary step to increase the diversification of the economy, boost exports and maintain the balance of payments.

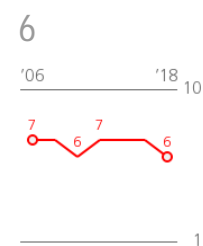
On December 21, 2015, in an abrupt move, the CBA announced its abandonment of its peg to the dollar, and switched to a “floating” exchange rate regime. As a result, the manat depreciated by an additional 47%. In total, within a year the manat depreciated by almost 100%, and people's lifetime savings lost their value by half. By the end of 2016, the official exchange rate was almost 1.8 manats to \$1, compared to 0.78 manats to \$1 two years earlier. Although the CBA claimed that it had switched to a floating exchange rate, economists argue that, in fact, it continues to control the exchange rate, and to spend reserves to prevent the manat from losing too much value.

With the drop of oil prices leading to the decrease in foreign exchange earnings, coupled with the increased demand by the banks for foreign currency, in the first half of 2016, the CBA ran through more than half of its foreign currency reserves. When the foreign exchange reserves dropped to \$4 billion, the central bank closed down all privately owned exchange offices and suspended the sale of foreign currency. These restrictions led to the creation of a black market, where dollar is sold at a higher than official exchange rate.

The chair of the CBA, Elman Rustamov, claimed that the abovementioned measures enabled the bank to increase its foreign exchange reserves to \$20 billion.

On September 14, 2016, the CBA increased its interest rate to 15%. In total, the interest rate has increased five-fold from 2015. With an increased discount rate, the

Anti-inflation /  
forex policy



CBA hoped people would keep their money in local currency. Yet many still continue to keep their savings in foreign currency.

Having a strong currency is regarded by the government as a prestigious indicator of strength and stability. Although with the establishment of the Financial Market Supervisory Board the central bank lost many of its powers, it is still responsible for the country's monetary and currency policies. Overall however, the CBA is not a transparent body, and is highly influenced by political decisions. Thus, the policies of the CBA are carried out, not based on factors that benefit the country's economy, but rather on political factors that benefit the regime.

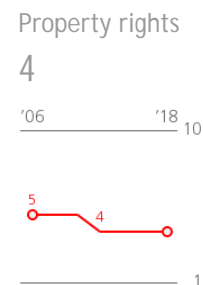
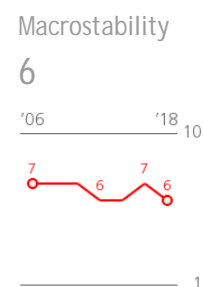
With the depreciation of the manat, purchasing power decreased and prices increased. In 2016, the official inflation rate reached an average of 12%. However, calculations by independent organizations estimate it to be much higher. Compared with 2015, food prices rose on average by 13% and non-food items by 16% in 2016. Communal costs, such as electricity and gas prices, also rose, with the biggest increase introduced at the end of 2016. With high prices, many families are buying less, and foregoing non-essential items on their shopping lists.

Since Azerbaijan is highly dependent on oil exports, the sharp decline in world oil prices led to a decline of oil revenues and budgetary transfers. According to the IMF, this resulted in a small -0.4% budget deficit in 2015, down from approximately 14% in 2014, but then moved up again to a surplus of 0.7% in 2016. As a result, the country had to borrow more money, leading to the increase in the ratio of public debt-to-GDP as well as external debt-to-GDP. The ratio of public debt-to-GDP increased to around 28% in 2015, compared to 11% in 2014, and the external debt ratio to approximately 21%. As more than 70% of the country's public debt was held in foreign currencies, the huge depreciation in the manat's value contributed to debt increase.

## 9 | Private Property

Property rights are not secure in Azerbaijan. The state and powerful oligarchs frequently violate them.

Despite the existence of legislation on property rights, there are still some gaps in the laws, and enforcement of current provisions remains very poor. The constitution and other laws dealing with property rights list conditions for expropriation, which is only allowed for state needs. The Civil Code defines state needs as the construction of roads or strategic defense complexes. However, the Law on Expropriation of Lands for State Needs introduced in 2010 expanded the definition of state needs, which led to the large-scale demolition of buildings in subsequent years. According to the law, private property is protected by the state against any other kind of infringement. But, because of high level of corruption, government officials and oligarchs have the



power to bypass the laws and expropriate private homes and retail spaces for their own private purposes.

Starting in 2009, private property rights came under massive attack because of government-sanctioned evictions and demolitions of private houses in several districts of Baku.

The most recent attack came in 2013 to 2016 when the government initiated evictions of residents of the Sovetsky District in central Baku. The government provided citizens with the price of 1500 AZN per square meter, making it difficult for people to afford to buy new apartments in the same district or its vicinities. As a result, many are forced to relocate to the outskirts of the city.

Many gaps remain in legislation for registering property. State officials frequently interfere with legal processes in order to extract bribes. Politically motivated infringements on property rights remain a problem as well. However, the process of registering property has been simplified to some extent with the creation of ASAN service centers. According to the Doing Business Report of 2015, Azerbaijan ranks 22nd among 190 economies “on the ease of registering property.”

In January 2015, the president issued a decree on the registration of undocumented homes built without prior government consent. However, a few years earlier, the president issued a similar decree, which did not yield expected results.

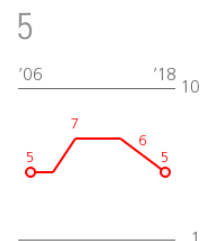
Azerbaijan has flaws and gaps in the laws aimed at protecting intellectual property rights. However, recently, new legislative acts, such as the law on Enforcement of Intellectual Property Rights and Fighting Against Piracy, have been adopted. Additionally, the Center for Enforcement of Intellectual Property Rights was created under the Copyright Agency in order to enforce intellectual property rights. The center is expected to issue copyright hologram stickers for certain products, such as software, books, CDs, DVDs, et cetera. Products without these marks will be considered pirated and fines will be imposed on their distributors.

Major local private companies are usually owned by government officials and their kin. Since the mid-1990s, there have been many cases of large or mid-scale enterprises taken away from their owners, who do not have links or ties to the ruling elite.

The “one window” registration system adopted in 2008 has resulted in an increase in the number of businesses over the past few years.

Moreover, according to Doing Business report, “Azerbaijan made starting a business easier by introducing free online registration services and eliminating preregistration formalities, [and] by reducing the time to obtain an electronic signature for online tax registration, [and] by abolishing the requirement to use a corporate seal.”

Private enterprise



However, pervasive corruption remains the biggest problem for doing business in Azerbaijan. Extensive bureaucracy, weak legal institutions, a high-level of corruption in customs and the concentration of businesses in the hands of high-level officials with monopolistic interests hamper the investment in the non-oil sector and create a lot of challenges for private businesses.

Although there are laws in place that make opening or registering private enterprises easy, there is still a lot of irregularity in the implementation of these laws. The operations of private businesses are prone to the pressure originating from government, oligarch-owned monopolies and widespread corruption. If business people are in trouble with the government, they can be subjected to biased and unexpected pressure from state agencies like the tax authorities or customs.

Additionally, the process of obtaining business licenses, certifications and loans acts as an administrative barrier hindering competition and toughening the environment for business operations. Moreover, corrupt government authorities continue to violate business procedures to advance their own interests.

Privatization procedures are well-defined on paper, but preference is often given to companies with a strong government connection, and tenders are not transparent at all.

## 10 | Welfare Regime

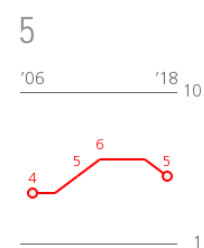
Provisions for pensions, illness compensation, disability, unemployment and maternity leave exist in national legislation, however, the welfare system in Azerbaijan suffers from considerable underfunding. Wages, pensions and illness compensation are low and do not cover living expenses. Health care is inadequate, especially for the poorer sections of the population.

The minimum wage has risen in the last several years, to 105 AZN (equivalent to \$56, considering recent devaluation of the manat). However, it has been offset by increasing prices, and thus is still too low to cover basic needs.

Family networks and money transfers from family members working abroad act as a stabilizing force for segments of the population.

Given the unreliability of government statistics, it is estimated that up to 25% of the employable population is unemployed. The state lacks an active employment policy and a functioning system of employment exchange. There is also no state support for the vast majority of the unemployed. Social stabilization constitutes one of the central challenges in the country's future.

Social safety nets



The constitution guarantees equal rights for all. In principle, all persons have equal opportunities for education and work. In practice, however, the effects of informal networks (nepotism) and widespread corruption and education costs (which effectively restrict access to education) undermine equal opportunity in Azerbaijan.

Almost all of the population receive at least some form of basic education, which is why the literacy rate stands at 99.8%.

Since the collapse of the Soviet Union, women's status within society has suffered to some extent and social structures remain male-dominated.

In rural areas, the prevalence of religious and parochial traditions often result in young girls dropping out of school.

Legally, women are entitled to the same rights as men, and they do participate in the labor force. In 2014 female labor force participation rate was 48.6%. However, due to cultural factors, women are excluded from leadership positions. Female professions have traditionally been underpaid, and gender-specific exclusion is evident.

Although female professionals can be found (primarily in the capital) among both the country's older, Soviet-trained and the younger, Western-trained generations, government offices are predominantly staffed by men. Most notably, it comes as no surprise that the cabinet (government) has only one female member: Hicran Huseynova, Head of State Committee for Family, Women and Children's Issues.

Azerbaijan's Gender Inequality Index in 2014 was 0.303. In this regard Azerbaijan lags behind not only East European countries, but also its neighbors Armenia, Georgia and Russia.

Ethnic origin does not appear to be a factor hindering hiring. Regional origin has tended to be important in Azerbaijan: Azerbaijanis from Armenia and the Nakhichevan exclave have generally privileged access to public office and employment.

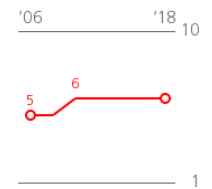
## 11 | Economic Performance

Decreasing oil production in the past few years has weighed heavily on economic growth. Budget surpluses observed during oil boom years have been turned into budget deficits.

With fiscal deficit, the government was forced to introduce tighter fiscal policy, decrease public expenditures, which resulted in the contraction of capital investment, as well as industrial production.

Equal opportunity

6



Output strength

5



Per the State Statistic Committee of Azerbaijan, the GDP in 2015 decreased by 3.9%, and the main contributor to this was a decline in the construction sector. This is the official data released by the government; yet the real decrease in GDP is estimated to be higher.

Aside from the decline in oil prices, and subsequent depreciation of the national currency, which led to the negative macroeconomic developments (e.g., high inflation, increased national debt and negative current balance), this also reflects the country's low economic performance, which can be attributed to the lack of diversity in industrial production (i.e., the extreme dominance of the oil and natural gas sector), high unemployment rates and low levels of domestic demand (i.e., an impoverished population).

According to the World Bank, Azerbaijan's trade balance remained positive. However, it has substantially decreased as a result of the decline of oil prices, and comprised around \$2 million in 2016.

The Ministry of Finance of Azerbaijan reported that the debt-to-GDP ratio had increased to 12.4%. It was the first time in ten years that this ratio had reached double digits. In 2016, the country's debt-to-GDP ratio further increased to 20.1%.

Azerbaijan's economy grapples with typical "Dutch Disease" problems, in addition to the undiversified economy. The government continued its tight fiscal policy in 2016, which further limited growth in the non-oil sectors.

Foreign direct investment (FDI) remains concentrated in the oil and gas sector, and attracting FDI to the non-oil sector remains one of the country's most pressing tasks. The official data from the central bank showed almost 7% decrease in FDI in 2015, and an 11% decrease in 2016. Official government sources put the unemployment rate at 5.5% in 2016. However, independent sources estimate that around 25% of the population is unemployed.

As a result of the devaluation of the national currency, in 2016 the inflation rate reached more than 12%, while the current account surplus diminished to 0.7%.

The state budget remains heavily subsidized by the State Oil Fund (SOFAZ). Indeed, the transfers from SOFAZ to the budget amounted to less than \$1 billion in 2007, but to over \$9.3 billion in 2015. In other words, the oil fund appears to be failing its main purpose of saving the oil windfall for future use. Instead, the country has grown dependent on large yearly transfers from the fund.

According to the State Statistical Committee, in the first half of 2016, the State Oil Fund's revenues stood at 6.1 billion AZN, while expenditures amounted to 6.8 billion AZN, which put the state's budget deficit at approximately 700 million AZN.

## 12 | Sustainability

Ecologically tolerable growth finds only marginal consideration and is institutionally not entrenched at all. Creation of the Ministry of Ecology and Natural Resources in 2000, and partial de-industrialization and the modernization of the petroleum and natural gas sector, achieved in cooperation with international consortia and donors, have not resulted in much improvement for the environment.

Serious environmental challenges remain. Damage incurred by the production and processing of petroleum and natural gas, industrial pollution (especially near Sumgayit), poor water quality, degradation of arable lands, deforestation, pollution and overfishing in the Caspian Sea, and the threat to nature reserves continue to pose massive problems.

In 2003, a National Program on Environmentally Sustainable Socioeconomic Development was developed. Later, the State Program on Renewable and Alternative Sources of Energy (2008–2015) and the Concrete Action Plan (2010–2020) for alternative sources were adopted. In 2013 to 2016, Greening Economies in the Eastern Neighborhood (EaP GREEN) was implemented by the United Nations Economic Commission for Europe to support EU's six Eastern Partnership countries, including Azerbaijan, to transition to green economy.

These initiatives are an important step in Azerbaijan's environmental policy, taking into account the fact that the energy sector is the main source of pollution in Azerbaijan. However, this legislation still needs further development and better implementation, which is hindered by a high-level of corruption.

Azerbaijan is also party to the Kyoto Protocol, but it still needs to implement its relevant provisions.

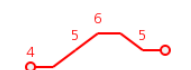
The educational system in Azerbaijan remains very poor. Inadequate training, ill-trained teachers and outdated textbooks continue to dominate all levels of education. The state kindergartens and secondary schools are infested with widespread corruption. According to the most recent report of World Bank Europe and Central Asia, Azerbaijan is the worst country in the region in terms of informal payments (bribes and under-the-table payments) made for access to both education and health care services.

In general, however, formal access to education in Azerbaijan is universal and free. The literacy rate is over 95%, albeit the poor quality of secondary level education is a well-known reality. In the 2009 Program for International Student Assessment (PISA) test for 15-year-olds, Azerbaijan did very poorly. Out of 65 countries, it ranked 64 in reading, 63 in science, and 45 in mathematics. As a result, the government refused to participate in the program again in 2012 and 2015.

Environmental policy

5

'06 '18 10

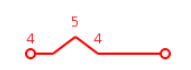


1

Education policy / R&D

4

'06 '18 10



1



Enrollment in tertiary education remains at about 20%, which is assessed by the World Bank as low for an upper-middle income country.

For decades, corrupt practices have dominated higher education, but newly launched institutions, like the ADA University (former Azerbaijan Diplomatic Academy) have become corruption-free zones in this industry. With the appointment of a new minister of education, the fight against corruption has slowly expanded to other state and private institutions of higher education, yet with varying success.

During the period under review, this positive trend received several serious setbacks. The secondary and higher educational institutions linked to the Turkish cleric Fethullah Gülen, which were long regarded as role models in the country, suffered a major blow as a result of pressure from the Turkish government.

A state program aimed at sending more students to study abroad was launched some time ago. However, despite the positive results that it has created, such as a higher number of students with foreign education, there were flaws with the program as well. Political loyalty considerations negatively impacted the selection process and damaged merit-based assessment. The government recently ended the program. The decision was based on the grounds that the experience collected over the past years should be evaluated before launching a new program.

Research remains an underdeveloped area of the economy; 3.1 and 3.2% of GDP was spent on education and research in 2015 and 2016, respectively. In late 2016 the minister of finance admitted that the state budget for research and education will diminish further due to the economic downturn. He also stated that all the funds allocated to the Science Development Foundation during the last two years had not been spent and that the foundation had accumulated enough assets to finance research for the next two years.

The foundation was established in 2009, by presidential decree, but so far has not made any significant difference in research output. Comparative analyses of annual data provided by SCImago Research Group, which ranks countries by measuring scientific indicators developed from the journals contained in the Scopus Database, show that Azerbaijani scientific output has not improved since the creation of the Scientific Development Fund. The lack of merit-based selection process is cited as the primary cause of failure. Political loyalty and cronyism dominates the unofficial selection criteria. Grants are informally confirmed by the president's office.

## Governance

### I. Level of Difficulty

Azerbaijan has favorable conditions for good governance, yet several factors negatively affect its development. First, there is a longstanding conflict between Azerbaijan and Armenia over the Nagorno-Karabakh region and seven adjacent territories that were occupied by Armenia in the early 1990s.

Another structural constraint originates from Azerbaijan's big neighbors. Azerbaijan borders Iran and Russia to the south and north, respectively. For the past several years, Russia's aggressive foreign policy has proven that the threat to the region from President Putin's ambitions is imminent.

Azerbaijan has a young religious Shi'a population. The structure of Shi'a Islam makes its adherents dependent on the Iranian religious establishment.

Azerbaijan is essentially landlocked, dependent on foreign countries for the export of the oil and gas that comprise the overwhelming majority of its foreign earnings.

The historical roots of civil society in Azerbaijan are very weak. In terms of local traditions, Azerbaijan is an authority-accepting and rather hierarchical society, in which the population has no tradition of organizing to obtain collective results.

Still, in the context of the broader Muslim world, Baku in the late 19th to early 20th century developed its own intelligentsia and political culture, which could have been an embryo of modern civil society. That potential was crushed by seven decades of Soviet rule; civic organizations during the Soviet period were controlled by the totalitarian state. Moreover, purges of the 1920s and 1930s almost completely eliminated the independent Azerbaijani intelligentsia. It was not until the 1960s, under Khrushchev, that, especially in academic and cultural spheres, a new national elite emerged. In the 1970s and early 1980s, the intelligentsia suffered again under the reintroduction of clientelist policies based on regionalism, nepotism and cronyism.

Since independence, NGOs supported by international organizations have emerged as significant players in public life. They have succeeded in mobilizing public opinion around a variety of social issues. Nevertheless, the ongoing crackdown, which started

Structural  
constraints

6

'06 \_\_\_\_\_ '18 10

6

\_\_\_\_\_ 1

Civil society  
traditions

8

'06 \_\_\_\_\_ '18 10

8 7 8

\_\_\_\_\_ 1

several years earlier, has seriously undermined, if not all but stopped this development.

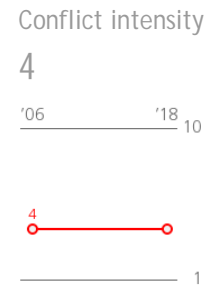
The Nagorno-Karabakh conflict, which has ethnic tensions at its roots, remains the only violent conflict in the country. Although a cease-fire has been in effect since 1994, in early April 2016, a major armed clash occurred, leading to worries of renewed war. Despite the restoration of the cease-fire a few days later, minor clashes are still continuing.

Representatives of other major ethnic groups, such as the Lezgins and Talyshes, have in the past advocated for separation, but remain currently unorganized and peaceful.

Social dissatisfaction, religious radicalism and the government's drive to close the sphere in which free media, freedom of assembly and independent political activities take place are other potential sources of conflict in the society. Since early 2015, the economic downturn has become a major concern. One year later, it led to several mass protests in several regions of the country.

The rise of tensions between the authorities and religious activists was one of the remarkable developments of the last two years. In late 2015, state police launched an armed operation in Nardaran (Shi'a stronghold on the outskirts of Baku) against the group of believers led by outspoken cleric Haji Taleh Bagirzade. The operation left several people dead, including both believers and policemen.

In 2016, the newly reorganized security agency (State Security Service) led operations against alleged Sunni radicals, which also resulted in the death of suspects.



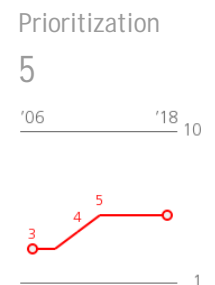
## II. Governance Performance

### 14 | Steering Capability

For a long period, the government tried to persuade internal, and especially external, actors, that it had adopted a gradual and deliberate strategy of promoting democracy. But while acquiring self-confidence due the inflow of oil revenues and enhancing its financial and political position, it started talking more openly about a “special way of building democracy,” which in reality meant its rejection and consolidating the authoritarian regime. This, along with the plight of media and civil society freedoms, has weakened the republican foundations of the state.

In terms of socioeconomic development, the government is focused on projects, such as improving the façades of big cities, by implementing construction projects and renovation efforts, especially in the capital Baku.

Question  
Score



Strategic programs are geared toward making Baku the venue for international events as well. It is thus no surprise that in 2015 Baku hosted the first European Games and in 2016 a Formula One race. Although hosting these events forced the government to carry out significant infrastructure renovations, especially in the public transportation system of Baku, and contributed to the promotion of the country's international reputation, both events were shrouded in controversy due to the corrupt practices of the regime.

Moreover, the economic downturn of last two years exposed the incompetence of the government, as well as its incorrect policies and corrupt practices.

In the beginning of the crisis it was clear that the government was caught totally unprepared. Even the president admitted this publicly. Just a few weeks before the collapse of the currency, the president and the director of the central bank assured the public in its stability and strength. Responses to the crisis in its early stages was also poorly organized and chaotic. As a result, the government had to rescind some of the measures introduced in the early stages of the crisis.

However, during the course of events the government was able to some extent to draw lessons from its own mistakes and to adjust implemented policies. It also made attempts to systemize its approach to the deteriorating situation and to consolidate control over the economy. A new post, assistant to the president for economic reforms, was introduced, and a number of new government agencies, such as the Financial Market Control Chamber, were created. In late 2016 The Strategic Roadmap of Economic Development was signed by the president. Diversification of the economy was declared a priority. The situation also forced the government to engage in minor liberalization, such as slightly easing the tough visa policies implemented before the crisis.

Even so, all these measures combined fell short of addressing major systemic problems of economy, such as the deeply entrenched high-level corruption, oligarchic monopolies, absence of the rule of law, widespread abuse of property rights, et cetera.

The recent decrease in oil revenues, due to the fall of prices and production, has forced the government to substantially reduce spending.

Another constraint remains widespread corruption. Overspending often appears to be related to the siphoning of money off projects for officials' private purposes.

Nevertheless, when the government attaches high priority to projects in the energy and transportation sectors or venues for international sporting and entertainment events, such as the first European Olympic Games, the Eurovision Song Contest, Formula One, the Islamic Games, it tends to successfully implement them, irrespective of spiraling costs. However, if oil prices remain low and there is no

Implementation

5

'06 '18 10



1

significant progress in diversification of the economy, it will be very difficult for the government to host and organize these types of events in the future.

Officials frequently emphasize their priority of diversifying the economy, but their achievements are not impressive, and the economy continues to rely heavily on oil revenues. The government intentionally delays the negotiations for the accession to the WTO, because of protectionism, mainly for the benefit of powerful oligarchs and their corrupt businesses.

The government has been less successful in decentralizing the political system and facilitating democratic reform, including implementation of the rule of law. The main obstacles are the unwillingness of the ruling regime to introduce changes in governance, entrenchment of the country's elites, and their reliance on autocratic, patrimonial methods of rule.

The government is willing to learn from the experience of international organizations that do not jeopardize its authoritarian nature and vested interests of high-ranking officials. This is especially true of technology, e-governance, business registration, as well as creating new types of modern educational institutions.

With Western advice, the government has set up a state agency for public service and social innovations, the Azerbaijan Service and Assessment Network (ASAN) featured with increasing number of service centers across the country in order to provide a variety of public services. These centers have eliminated to a certain extent corruption in public service and receive a great deal of praise from the population.

However, the government has completely brushed aside Western advice on issues relating to political and market reforms, building civil society and implementing the rule of law.

Nevertheless, the country has been independent for over 25 years and some local experience has accumulated. As a whole, however, top-down management remains the rule.

## 15 | Resource Efficiency

The state budget depends heavily on oil revenues, which until recently led to high GDP growth rates for several years. However, because there was no diversification of the economy, there were concerns that once the country runs out of oil reserves, growth would slow down, eventually leading to economic decline. The actual 4% drop in GDP in 2016 due to the falling oil prices proved these concerns correct.

The question of how to use oil revenues appropriately has hung over the Azerbaijani government for years. Although some steps were taken, such as establishing the State Oil Fund, keeping transparent income records on oil revenues and separating oil

Policy learning



Efficient use of assets



revenues from the state budget, the expenditure of oil revenues (once transferred from the fund to the state budget) raises serious concerns among citizens and experts.

The government has undertaken several projects for the betterment of the economic and social situation in the country. Massive investments have been used to construct new roads, schools and hospitals. Yet, little transparency exists and there is no doubt that officials have been misappropriating funds. Some improvements in social services and education have also been made.

Enormous sums of money have been wasted on allegedly prestigious projects, primarily in sports.

There are many Western-educated youth, who are graduates of various exchange programs, or have completed their education with financial support from their families. Upon their return, they primarily choose to work in private enterprises or in international and foreign organizations, because of the significant role of meritocracy in their hiring practices and due to the low salaries in state institutions. However, during the past several years the number of Western-educated Azerbaijanis joining state institutions as mid- and high-level officials has been on the rise as well.

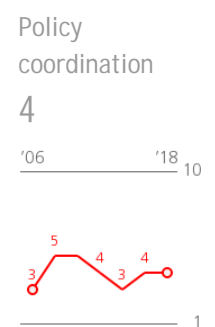
But most recently the sudden economic downturn and shrinking hope for much-needed political and economic reforms have forced many Western-educated young specialists, among others, to leave the country and search for a better life elsewhere.

Policy coordination is a major problem for the government. State policies are often developed in such a rushed manner that no time is allowed for coordination with relevant state agencies. Some ministers and other high-ranking officials have a sense of being independent monarchs, lacking responsibility or accountability to their colleagues. There is no sense that the cabinet of ministers functions as a coherent unit.

Moreover, key cabinet members have their own private economic interest that often involves a near-monopoly on certain sectors of the economy. As a result, an informal understanding exists as to what sectors or even regions are controlled by what oligarch, and some forms of coordination are simply off limits for other stakeholders. Vested interests and conflicts among the various ministries and ministers often prevent effective coordination of state programs.

Nevertheless, in very important political decisions that are crucial for the stability of the regime, i.e., combating the opposition and implementing major projects, the government shows unity.

Unlike his father who was the absolute authority in the country, the current head of the state, in spite of remaining the most powerful figure, is influenced significantly in his decisions by powerful oligarchs and takes their interests into consideration.



Still, the overall dynamics are of the gradual consolidation of authoritarian rule, accompanied by the increasing influence of the president.

Corruption in the country is widespread and has a centralized nature. So far, the government was not interested in seriously combating corruption on a high level and thus the large majority of government institutions are badly compromised. The anti-corruption law, which was passed years ago, and the Commission on Combating Corruption have not become substantial tools in the fight against corruption.

However, the recent economic downturn urges the government to take serious measures to combat high-level corruption in order to save the troubled economy and be able to satisfy basic social needs of the population. Recently, the president made some public announcements about his willingness to fight the entrenched high-level corruption and introduced some new measures. But whether the president has the political will and enough authority to implement this policy remains to be seen.

So far, in comparison with other state agencies, the Ministry of Foreign Affairs, the State Exams Committee (which was renamed the State Examination Center in 2016) and the State Oil Fund are involved in less corrupt activities. ASAN, which was established several years ago and has since expanded, was initially launched to reduce low and mid-level corruption.

There are some improvements in higher education, as explained in other sections of this report. However, the state kindergartens and secondary schools, as well as the state health care system, are still infested with widespread bribery practices.

## 16 | Consensus-Building

The most significant political actors from the secular opposition claim that they struggle for democratization of the country and support republicanism as the only way of governance.

Until recently, the government claimed that it also was pursuing a path to democratization, but insisted that stability, security and social order were prerequisites for democracy, and that the democratization process should be gradual, cautious and based on cultural modernization.

However, the opposition has always accused the government of monopolizing power and using stability, social order, and the cultural progress of the people as excuses to turn the republic into a monarchy. The events that unfolded in Azerbaijan following the presidential election of 2013 somewhat upheld the opposition's claims and the referendum of 2016 further cemented this assumption.

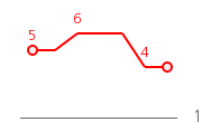
Anti-corruption policy  
2

'06 '18 10



Consensus on goals  
4

'06 '18 10



Moreover, for some time, the government has made new, confusing claims, which can be explained as a rejection of the path to a liberal democracy.

Almost all political actors in Azerbaijan agree on the need for a market economy. But, as usual, there are discussions between supporters of a laissez-faire approach and advocates of the government assuming greater responsibility.

Most recently, radical communist views have become popular among some youth groups.

Still, the corrupt oligarchic nature of the ruling regime hampers the economy by exploiting the benefits of a fully functional market economy. Monopolies in both exports and imports are in the hands of oligarchs, who are simultaneously high-ranking state officials. The concentration of both administrative and business powers in the hands of the corrupt elite has contributed to the existence of a huge informal sector. Customs, tax and transportation authorities are especially notorious for taking bribes. The names of the heads of the State Oil Company and the central bank and some influential members of the parliament have also come up in international corruption scandals.

However, the recent economic downturn pressures the government to make changes to its corrupt practices. The president publicly announced some measures to combat high-level corruption and carry on with market economy reforms. It remains to be seen whether he has the political will and enough power to honor his pledge.

The ruling party has a very strong grip on political power, and exercise of this power is not transparent. Real power is vested in individuals rather than in the functional government offices.

Some state agencies try to hire young, Western-educated staffers to implement policies in a more efficient manner, but power is overall in the hands of policymakers who do not favor rapid democratization or market reforms.

The case of the ADA University (formerly Azerbaijan Diplomatic Academy) and ASAN is telling: When the president sought to develop modern institutions that would operate with integrity, that development had to transpire outside the realm of government agencies, indicating the pervasive nature of the opposition to reform in many state sectors.

In spite of its official pro-democracy stance, the ruling regime is the main veto actor in democratization. Not only did the incumbent fail to facilitate democratic reforms at national or local level, signs of growing authoritarianism have become undeniable in the last few years. Crackdowns on independent media, domestic and international NGOs, civil society and human rights activists, persecution of political dissent and

Anti-democratic actors

2

'06 '18 10

4

3

2

1

10



further reduction of civil liberties were among the main indicators of the ruling regime's anti-democratic nature.

Some local and international observers claim that there are a few reform-minded actors within government structures. Usually, they mention the leadership of the Ministry of Foreign Affairs, Finance, Education, as well as central bank officials and the first lady's family members. However, it seems that, so far, these have largely failed to bring any serious changes to government policies, although some initiatives like the aforementioned ADA, ASAN have been realized.

The government prioritizes the preservation of stability as the most important value in its domestic and foreign policies. Moreover, the stability factor is propagandized as the government's best achievement and the basis for its legitimacy.

All potential conflicts, whether they have religious, ethnic or social basis, are prevented and suppressed. The government has often sought to suppress dissent rather than engage in consensus-building.

Lack of comprehensive long-term policies and the reliance on authoritarian measures for short-term purposes contribute not to the solution, but to the preservation of problems.

The fact that the ruling elite is often viewed as composed mainly of Azerbaijanis coming from Nakhichevan and Armenia serves as a source of potential tensions in society as well, because people from other regions resent having unequal access to power and wealth.

The Azerbaijani government frequently praises its religious tolerance as part of the national tradition. It holds many pro-forma international events on multiculturalism, religious tolerance and dialogs. The year 2016, for example, was declared that of multiculturalism in Azerbaijan. However, the government is frequently criticized for oppressing freedom of religion.

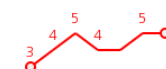
Since 2013, the government has launched a crackdown in an attempt to close the space for any independent activity and critical voices. Both local and international NGOs have begun to encounter serious restrictions. Numerous international donors and NGOs were forced out of the country; strict laws were adopted; bank accounts were frozen; travel bans were imposed; trumped-up criminal cases were launched and many local NGO activists were imprisoned; some sought refuge in foreign countries. Almost no space was left for NGOs' independent activities. Religious groups have also constantly been targeted in the past few years. Despite the fact that NGO activists imprisoned earlier were released in 2015 and 2016, the crackdown did not stop.

Overall, civil society in Azerbaijan has been effectively stifled.

Cleavage /  
conflict  
management

5

'06 '18 10



1

Civil society  
participation

2

'06 '18 10



1

In the late 1990s to early 2000s the government of Azerbaijan, in order to establish control over activities of non-governmental organizations, supported the foundation of the National NGO Forum of Azerbaijan. The head of this organization, Azay Guliyev, became a member of parliament. In 2008, the Council on State Support to NGOs state agency was created and Azay Guliyev again appointed its head. These moves have to be considered as part of a broader government policy aiming to get rid of independent civil society groups and replace them with GONGOs (government-organized non-governmental organizations) that imitate civil society.

A comprehensive process of reconciliation has not been initiated because the government continues to portray its political predecessors as a root cause for major economic and political failures. However, some steps were taken. For instance, the law on former presidents was passed to allow state pensions to them or their families. Former president Ayaz Mutallibov, who had been in exile in Moscow since 1992, was allowed to return to the country in July of 2012.

For political reasons, the parliamentarians who were the authors of the 1991 Declaration of Independence have been repeatedly denied pensions as retired lawmakers. The government justifies its action by claiming that they were elected before independence.

Genuine reconciliation can only be initiated by the ruling elite; so far, however, it has demonstrated little interest in this regard. Although the government verbally expresses its desire for dialog, it has never initiated a genuine one. Calls from independent NGOs and opposition groups for reconciliation were disregarded as well.

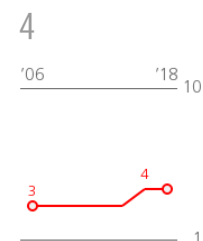
The elite has genuinely reconciled only with those former rivals who have either lost political clout or stopped seriously challenging the government's grip on power, as well as with those who agreed to keep a low public profile.

## 17 | International Cooperation

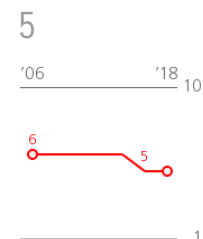
Azerbaijan's government generally cooperates with international partners in the area of economic development and poverty reduction. The World Bank, the United States Agency for International Development (USAID) and the Asian Development Bank are among the government's biggest partners. As was indicated in the most recent Human Rights Watch report, "international financial institutions have continued or increased funding to the Azerbaijani government, including in the extractives industries, despite the worsening human rights situation."

The Azerbaijani government did not conclude an Association Agreement with the European Union, arguing that its provisions do not match Azerbaijan's interests and jeopardize independence and sovereignty. The government claims that it tries to

### Reconciliation



### Effective use of support



maintain a non-alignment policy. However, it is obvious that the main reason behind the government's decision is its unwillingness to commit itself to genuine democratic reforms.

On November 14, 2016, the European Council adopted a mandate for the European Commission and the High Representative for Foreign Affairs and Security Policy to negotiate a comprehensive new agreement with the Republic of Azerbaijan, which would allow the latter “to decide the extent in which it will participate in the EU's offer of political association and economic integration. The new agreement should replace the 1996 partnership and cooperation agreement and should better take account of the shared objectives and challenges the EU and Azerbaijan face.”

In the economic realm, delay in joining the WTO occurs primarily because of the government's reluctance to give up corrupt practices in its economic policies and to reform its customs, tax and other procedures.

In 2013, Azerbaijan curtailed the activities of the OSCE office in the country, and moved to reduce the presence of international NGOs in the democracy field, such as the U.S. National Democratic Institute, IREX and a few others. However, in 2016, a representative of Azerbaijan was elected Vice-President of the Parliamentary Assembly of OSCE.

In times of high inflows of revenue derived from oil, in December 2012 the president signed a document called Azerbaijan 2020: Look into the Future, which outlined the concept of the country's development. This document received critical assessment from local independent experts and was dubbed a publicity stunt, rather than a real development program.

However, the sharp economic downturn forced the government to draft a new document called Strategic Roadmaps for the National Economy and Main Economic Sectors, approved by the president in December 2016. According to assessments by local independent economists, it is professionally better prepared and more importantly, feasible. Moreover, unlike the previous program, its results are measurable. Yet, achieving its targets will depend on the political will of country's leadership to implement reform.

The Azerbaijani government has been rather consistent in fulfilling its major economic and business commitments to the international community. For instance, it has never sought to renegotiate oil contracts signed in 1994.

However, although the current government tries to act as a reliable partner, problems emerge with the acceptance of international liberal norms when material interests of the ruling elite are directly affected. This was the case when Azerbaijan failed to negotiate an Association Agreement with the EU and failed to join the WTO.

Credibility

6

'06 '18 10



1

The biggest question marks surround Azerbaijan's commitments to Council of Europe and the OSCE in the field of democracy and human rights, which have grown increasingly critical of Azerbaijan's record in the area. Azerbaijan refused to release political activist Ilgar Mammadov, despite a ruling by the European Court of Human Rights in his favor.

The country's poor record on human rights has also been criticized by the European Union and other international organizations, but to no avail. The situation continues to deteriorate.

Azerbaijan is a locomotive of regional cooperation, actively investing in neighboring and other countries. It promotes east-west and north-south energy and transport corridors; builds ports, transport hubs. The country invests in efforts at extending and diversifying gas pipelines to Europe. Currently, the Shah Deniz Stage 2 Project, which will transport natural gas from Azerbaijan to markets in Europe through the Southern Gas Corridor (includes the South Caucasus Pipeline (SCP), the Trans-Anatolian Pipeline (TANAP) and the Trans-Adriatic Pipeline (TAP)) is a major priority.

The country plays a significant role in regional organizations such as Transport Corridor Europe-Caucasus-Asia (TRACECA). Azerbaijan's role in regional organizations such as Georgia, Ukraine, Azerbaijan and Moldova (GUAM) and Black Sea Economic Cooperation (BSEC) is equally key.

The country puts enormous efforts into maintaining good relations with its neighbors. Trilateral cooperation between Azerbaijan, Turkey and Georgia is of particular strategic importance and in healthy shape. Azerbaijan is among the significant contributors to the economies of these two countries. The joint project of the Baku-Tbilisi-Kars Rail Line is designed to extend from Azerbaijan to the capital city of Georgia and into Turkey. It is designed to be part of New Silk Road to connect Europe with China.

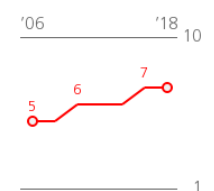
There is no doubt that a competition over Azerbaijan is accelerating between the region's big powers. Despite certain problems in the relations of Azerbaijan with Russia and particularly Iran, Baku hosted the meeting between the leaders of these three countries in the late summer of 2016. As a result of this meeting, a joint declaration pledging to develop trilateral political and economic cooperation was signed.

The country has remained compliant with the rules of regional and international organizations, except on the issues of democracy and human rights.

However, there is no cooperation between Azerbaijan and Armenia due to the Nagorno-Karabakh conflict. Baku rejects establishing any bilateral relations as long as Armenia does not abandon its occupation policy.

Regional cooperation

7



## Strategic Outlook

So far, the Azerbaijani government has managed to maintain its grip on power by providing security and stability. Yet this has primarily been achieved by the iron fist by squeezing out space for independent political and economic activity and by the ongoing crackdown on secular democratic opposition, independent media and civil society. Authoritarianism has been consolidated by expanding the unchecked powers of the executive office and establishing its full control over all spheres of public life. The system of checks and balances was left without actual powers. Moreover, the flow of big oil money provided the government with means to satisfy the basic needs of the people, reduce the poverty and carry out modernization and renovation of infrastructure.

However, the unexpected economic downturn of the last two years, due to falling oil prices, corruption and mismanagement exposed the deep economic and political vulnerabilities of the existing system. There will be challenging years ahead.

The future of Azerbaijan and long-term prospects for the ruling elite hinge on the progress of urgently needed reforms. It is obvious that recovery will be very difficult to achieve without liberalization of the political and economic systems and implementation of the basic principles of the rule of law. Specially, the government must launch real combat against rampant, high-level corruption, proceed with market-based reforms and diversify the economy. Yet, thus far, the Azerbaijani government has tried to respond to the challenges it faces only with half-hearted measures. The ruling elite has remained characteristically unwilling to embark on major economic and political reforms, especially of a structural nature. Use of arbitrary power to consolidate control over economic life is still the main response to new problems.

In addition to the economic downturn, there is a possibility that the government will be challenged by rising political Islam in the medium term. Diminishing space for the activities of civil society, independent media and secular opposition, very well documented by international human rights organizations, boosted opportunities for both Sunni and Shi'a Muslim groups to replace weakened democratic forces as the strongest voice of dissent. The government is working to curb political Islam, likewise primarily through suppression.

However, it should be underlined that the secular nature of Azerbaijani society remains relatively strong, but in no case should it be taken for granted.

Another major challenge is the Nagorno-Karabakh conflict, which almost escalated to a full-blown war in April 2016, claiming many lives on both sides. It currently poses a serious threat to stability in the region. Resolving the conflict with Armenia was intrinsically linked to forging closer ties with Europe and, in turn, the acceptance of liberal values and standards by Armenia and Azerbaijan. However, this opportunity was not embraced. As a result, the perspective is now full of uncertainties. Beyond this, uncertainty is strengthened by rising geopolitical complexities due to the resurgence of authoritarian tendencies and the decline of liberal democracy both in the region and globally.